No. 15607

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

F. M. BISTLINE and ANNE BISTLINE,
husband and wife,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

Brief of Appellant

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GATEWAY PRINTERS—POCATELLO

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JURISDICTION

This action is for the recovery of certain income tax paid by appellants to defendant for the year 1948. The Internal Revenue Bureau disallowed certain long term capital gains claimed by appellants in said return and set up a tax deficiency by reason thereof. Appellants paid the taxes so assessed and thereafter filed a claim for refund, which was disallowed, after which appellants filed this suit. These facts appear in appellants' complaint (Tr. page 7).

Federal Statutes conferring jurisdiction are:

28 USCA Sec. 1346; 68 Stat. 589.

28 USCA Sec. 7422; 68A Stat. 876.

STATEMENT OF THE CASE

In 1937 appellants acquired an undivided one-half interest in the Southeast Quarter of Section 12 and the Northeast Quarter of Section 13, Township 6 South, Range 33 E. B. M., in Power County, Idaho. Eleven years later, 1948, they sold 210 acres of this tract to the Westvaco Chemical Corporation for a profit of $8,719.66. This was reported in their 1948 joint income tax return as a long-term capital gain and tax was paid accordingly on one-half of such net gain.

In 1954 an Internal Revenue Agent examined appellants 1948 return and disallowed the long term capital gain treatment used by them with regard to this property and certain other real estate transactions, and assessed deficiencies against appellants setting up $4,359.83 additional income by reason of such disallowance with regard to this particular tract. Thereafter appellants paid the tax on same and filed a claim for refund which was denied. Appellants then brought this suit for the recovery of the tax paid on this particular piece of property, together with the other real estate sales of vacant lots made during the same year.

This case was consolidated with two other cases filed by appellants for recovery of taxes paid by reason of dis-

allowance of long term capital gain benefits on certain real estate sales in 1946 and 1947. Consequently the findings of fact, conclusions of law and judgment are with reference to all the items in the three suits (Tr. p. 16). Appellants have elected to appeal only from that part of the judgment denying long term capital gain benefits on the particular parcel described above sold to the Westvaco Chemical Corporation in 1948.

The background of the sale of the 210 acre tract in 1948 to the Westvaco Company is: J. Paul Evans and F. M. Bistline acquired approximately 4000 acres of land lying on the Michaud Flat west of Pocatello about eight to 10 miles on the Fort Hall Indian Reservation in 1937. This property was originally acquired by L. L. Evans, father of J. Paul Evans from the original Indian owners about the year 1915 or 1916. In 1923 all of this property was sold under execution on judgments against L. L. Evans. Thereafter and in 1924 L. L. Evans quit claimed this 210 acre tract and other land to J. Paul Evans who redeemed the same. It was subsequently sold under other judgments against L. L. Evans and was the subject of a law suit involving the validity of such subsequent sale, when Power County offered it at public sale along with property taken for non-payment of taxes. This was in 1937. F. M. Bistline and Evans Investment Company (J. Paul Evans) were the successful bidders for this land, which was included in the approximately 4000 acres mentioned above.

While under the ownership of L. L. Evans he installed

a pumping plant in the Portneuf River for the purpose of irrigating a portion of this 210 acres and the other of the approximately 4000 acres of land on the Fort Hall Reservation owned by him, but never completed the same on account of financial difficulties. In 1932 Congress enacted a law authorizing the extension of the Fort Hall Irrigation Project to cover the Michaud Flats which would have furnished water to a portion of this particular tract.

After Evans and Bistline acquired this and the other land referred to above on the Reservation, they started development of the same by installing pumps, and also working for the irrigation of the same through the Greater Fort Hall Irrigation project with waters from Palisades Dam. From the time that L. L. Evans first acquired this land it was used for the grazing of livestock, and at the time it was sold it was being used by the Evans Investment Company for the grazing of its livestock and was considered as being an integral part of the farming operation of the Evans Investment Company. It had been used by the Evans Investment Company continuously for a great many years before its sale in 1948 for grazing its livestock.

In the Fall of 1947, J. Paul Evans was contacted by representatives of the Westvaco Company, O. R. Baum and O. A. Powers, with regard to the sale of this 210 acres of ground. F. M. Bistline at the time was in the eastern part of the United States. O. R. Baum in a long distance telephone conversation with Bistline at Memphis, Tennessee, called this matter to his attention. On his return to Poca-

tello in the early part of November, Bistline, Evans, Baum and others for Westvaco conferred with regard to this matter, and finally by May of 1948, a sale of this land to the Westvaco Company was completed. Pressures were put on Evans and Bistline to sell this tract because community leaders were anxious to have the Westvaco factory located in the area.

Appellants and Evans on behalf of the Evans Investment Company at no time made any sales of the Michaud Flat land to private individuals, but sales were made in the public interest. They sold 80 acres to the City of Pocatello for Municipal Airport purposes; 160 acres to the Fort Hall Indian Tribe; and 80 acres to Simplot Fertilizer Company, or more correctly to a governmental agency, who in turn sold to Simplot for the Simplot Fertilizer factory.

Appellants and Evans worked diligently to get water on the land and by drilling wells and also on the project of getting water from the Palisades Dam with the hope of getting the land under irrigation, and were not interested in selling any of the land. After completing the sale to Westvaco of the 210 acres, they turned down a further sale of adjoining land for which a written offer was given them at prices higher than that paid for the 210 acres. This was received in evidence as Plaintiff's Exhibit No. 3. This land was not held for sale by appellants nor the Evans Investment Company, but was held for development as irrigated farm land, and was currently being used for grazing at the time of the sale: (Tr. pages 30-35; 36-39).

QUESTION INVOLVED

The only question involved is whether or not the real estate sold to Westvaco Chemical Company by the appellants was entitled to long-term capital gain tax treatment.

This question is raised by the appeal from that part of the judgment denying appellants recovery for the taxes paid by reason of the court holding that it was not entitled to such treatment. Appellants' attack upon the judgment with regard thereto is that the evidence is conclusive that said property was used in trade or business and was held as an investment and the sale thereof entitled to long-term capital gain treatment.

SPECIFICATION OF ERROR

I.

The District Court erred in entering judgment denying appellants the right accorded by the Statutes in such cases made and provided to pay their income tax on one-half of the gain realized by them on a sale during the year 1948 of a parcel of real estate which had been acquired by them in 1937 and referred to in the complaint and described as follows: Interest in tract in Southeast Quarter of Section 12 and the Northeast Quarter of Section 13, Township 6 South, Range 33 E. B. M., and commonly referred to in the evidence as the "Westvaco Sale" for the reason that the evidence in the record is conclusive that said property was

used in trade or business of farming and held as an investment.

SUMMARY OF ARGUMENT

I.

1. The evidence is clear and uncontradicted that the particular tract in question sold to the Westvaco Chemical Corporation was an integral part of a farming unit and therefore falls within the critical language of Section 117 (j) (1) of the Revenue Act in effect in 1948 which defines a capital real estate asset as "real property used in the trade or business held for more than six months" and that it was not property held by the taxpayer primarily for sale to customers in the ordinary course of their trade or business.

26 USCA Section 117 (j) (1) (2);

1956 CCH p. 4729. 801;

McCoy vs. C. I. R. 192 F. 2d 486 (1951) (CA 10, Kansas);

Watson vs. C. I. R., 197 F. 2d 56 (1952) (CA 9, California);

Owen vs. C. I. R., 192 F. 2d 1006 (1951) (CA 5, Florida);

Irrgang vs. Fahs 94 F. Supp. 206.

II.

A Taxpayer in the real estate business may hold other property as an investment and capital assets, and profit on the sale of such property will be entitled to long-term capital gain treatment.

Lobello vs. Dunlap, 210 F. 2d, 465;

Goldberg v. C. I. R., 223 F. 2d 709;

Malouf vs. Ridell 52-1 USTC p. 9296;

Farry vs. C. I. R., 13 TC 8;

Jones vs. C. I. R., 1 TCM 816;

Miller vs. Com'r., 20 BTA 230;

Hutchinson vs. Com'r., 8 TCM 597;

Frieda E. J. Farley, 7 TC 196;

Victory Housing No. 2 vs. Com'r., 205 F. 2d 371;

Delsing vs. U. S. 186 F. 2d 59;

McGah vs. Com'r., Int. Rev. 210 F. 2d 769;

Burkhard Investment Co., vs. U. S. 100 F. 2d 642;

Harriss vs. Com'r., 143 F. 2d 279;

Dunlop v. Oldham Lumber Co., 178 F. 2d 781;

Collin vs. U. S. 57 F. Supp. 217;

Vaugh vs. Com'r., 7 TCM 288;

E. R. Fenimore Johnson, 19 TC 93.

III.

Where property is acquired by taxpayer and sales made with little or no activity on his part, the profits realized therefrom are entitled to capital gain treatment.

Camp vs. Murray, 226 F. 2d 931 (1955) (CA 4, Virginia);

Smith vs. Dunn, 224 F. 2d 353, (1955) (CA 5, Georgia);

Martin vs. U. S., 119 F. Supp. 468 (1954) D. Ct. Georgia);

McConkey v. U. S., 130 F. Supp. 621 (1955) (Ct. Claims, Virginia);

Hebenstreit vs. U. S., 55-2 USTC p 9571 (1955) (New Mexico);

The Adam Schantz, Sr. Corp. vs. Com'r., 11 TCM 424 (1952) (Ohio);

Minnie S. Loewenberg vs. Com'r., 7 TCM 702 (1948) (Texas);

Kleberg, Est., of, vs. Com'r., 5 TCM 858;

Ellis v. Com'r., 13 TCM 15 (1954) (South Carolina);

Three States Lumber Co., vs. Com'r., of Int. Rev., 158 F. 2d 61 (1946) (CA 7, Arkansas);

Guthries vs. Jones, 72 F. Supp. 784 (1947) (Oklahoma);

Storrow vs. U. S., 99 F. Supp. 672 (1951) (D. Ct. California);

Frieda E. J. Farley, 7 TC 198 (1946) (Louisiana);

Est. of Douglas S. Mackall vs. Com'r., 3 TCM 701 (1944) Virginia.

IV.

Where lawyer taxpayer acquired property and made sales which were unsolicited on his part, the profit made from such sales was income from the sale of a capital asset and entitled to capital gain tax treatment.

Fahs vs. Crawford, 161 F. 2d 315 (1947) (CA 5, Florida);

Boomhower vs. U. S. 74 F. Supp. 997 (1947) (Iowa);

Ross v. Com'r. Int. Rev., 227 F. 2d 265, (1955) (CA 5, Florida);

McKay vs. Bowers, 53-2 USTC p 9535 (1953) (South Carolina);

Sparks vs. U. S., 55 F. Supp. 941 (1944) (D. Ct., Georgia).

FEDERAL STATUTES INVOLVED

Sec. 117, Title 26. CAPITAL GAINS AND LOSSES.

(a) DEFINITIONS: As used in this chapter—

(1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include * * * property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation * * * or real property used in the trade or business of the taxpayer; * * *

(4) LONG-TERM CAPITAL GAIN.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

(j) (1) DEFINITION OF PROPERTY USED IN THE TRADE OR BUSINESS.—For the purpose of this subsection the term "property used in the trade or business" means property used in the trade or business of a character which is subject to the allowance for depreciation * * * held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would be includible in inventory * * *, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. * * *

(2) GENERAL RULE.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion * * * of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses. * * * . (Immaterial parts omitted as indicated by asterisks).

ARGUMENT

It is appellant's contention that the 210 acre tract sold by appellants and Evans Investment Company to the Westvaco Chemical Corporation for use as a factory site was an integral part of a farming and livestock raising operation

and as such in trade or business within the meaning of Section 117 (j) (1). They also contend that they held it as an investment.

I.

Real property used for grazing livestock in connection with the trade or business of farming held for more than 6 months is "property used in the trade or business" as defined in Section 117 (j) (1), and on the sale thereof entitled to capital gain treatment.

26 USCA, IRC, Sec. 117 (j) (2) in effect in 1948;

1956 CCH, p 4729. 801.
Cases cited under *SUMMARY OF ARGUMENT* Numbered 1.

Where real property is used in trade or business for more than 6 months *it cannot be held primarily for sale* to customers in the ordinary course of business or trade by reason of the words "* * * which is not * * *" occuring in said Section 117 (j) (1). Quoting:

> "Section 117 (j) (1) * * * the terms "property used in the trade or business" means * * * real property used in the trade or business held for more than 6 months *which is not* * * * (B) property held by the taxpayer primarily for sale to customers in the or-

dinary course of his trade or business * * *" (Italics ours).

Therefore it must fall into one category or the other. From the plain wording of the statute it cannot be both.

In *McCoy vs. Com'r., Supra,* the Court had this to say with regard to the construction of the statute in this regard:

> "The critical language of Section 117 (j) (1) of the Revenue Act of 1946 and 1947 defines a capital real estate asset as "real property used in the trade or business held for 6 months' * * **. The words "real property" are without qualification."

This court in Watson vs. Com'r., Supra, disagreed with the 10th Circuit with regard to the nature of growing crops but not with regard to the land itself.

We feel that it is not necessary to repeat much of the evidence in support of our contention. We refer the Court to the Transcript pp 30-36, and pp 36-42 the testimony of F. M. Bistline and J. Paul Evans respectively, for a statement as to how this land was acquired, how it was used, what was planned with regard to it and the circumstances of the sale, and do call particular attention to the fact that this land on the Michaud Flat was not for sale.

> "It has always been our plan to hold that land and not sell it, however, when it was in the public in-

terest we were willing to make a sale," (F. M. Bistline testimony Tr. p. 33).

"I never did place this property or any of the Michaud property on the market with a view of selling it, I have done considerable developing of that property out there. I put down the irrigation wells, and irrigated some 300 to 400 acres of land. The first well was put in in 1940 or 1941. The one on the west side of the tract next to the airbase, east of the airbase was put in 1944, and I put another one down in 1948 on the south side, and then about two weeks ago I put another one down on the south side of the tract . . . I intended to keep this property to farm it." (J. Paul Evans Testimony Tr. p. 37).

Also attention is called to Exhibit 3,—the offer made by the Westvaco Company for additional land which was rejected by appellants and Evans.

The trial court apparently got the idea that this parcel together with the other Michaud land was purchased by Evans and appellants as delinquent tax property. (Memorandum decision Tr. p. 18). "In 1937 F. M. Bistline and Paul Evans * * * purchased 3000 acres of land in the 'Michaud Flats' area at a Power County Tax sale." This was not the case. This land was owned by Power County through execution sale, subject to a lawsuit by Evans contesting its validity, at the time of the sale.

"These law suits were brought by the County on account of depository funds signed by these directors (of the First National Bank of American Falls) and Mr. Evans. This suit was pending in the Circuit Court of Appeals and the County was holding a tax sale, and they put that property up for sale along with the tax sale of tax lands." (F. M. Bistline Testimony Tr. p. 31).

This land was redeemed once (Tr. pp 30-31). It had been in the Evans family ownership for over 40 years, except when under execution sale, which was under attack (Tr. 30, 36).

"I recall the plans we had with regard to the Michaud property. I planned on farming it and grazing it. I was running livestock at that time. I was using this for grazing and had been using it for grazing since we acquired it." (J. Paul Evans, Testimony Tr. p. 36).

"There was an authorization for an irrigation system on that through the Indian Affairs Department in 1932 to put that under water" (F. M. Bistline testimony p. 32, 33. Transcript).

The owners were working to get water from the Palisades dam (Tr. pp. 31). (Note: This dam has since been completed and work is in progress for putting the Michaud Flats under water as the Greater Fort Hall Indian Reservation Project).

II.

A taxpayer in the real estate business may hold other property as an investment and capital asset, and profit on the sale of such property will be entitled to capital gain treatment.

Lobello vs. Dunlap, 210 F. 2d 465 (1954-CA 5, Texas);

Goldberg vs. Com'r 223 F. 2d 709 (1955-CA 5, Texas);

Malouf vs. Ridel, 52-1 USTC p. 9296 (1952-California);

Farry vs. Com'r., 13 TC (1949-Texas);

Jones vs. Com'r., 1 TCM 816 (1943-Virginia);

Miller vs. Com'r.. 20 BTA (1930-Michigan).

The only one of these cases arising within the jurisdiction of this court is *Malouf vs. Riddell, 52-1 USTC p. 9296,* a California case decided in 1952. Here taxpayer was a partner in the Malouf Realty Company. He sold certain real estate held by him for investment purposes to the Burbank Unified School District and contended that said sale was the sale of a capital assets and that the profit therefrom should be treated as a capital gain. The jury so held. It was instructed by the Court that dealers in real estate are permit-

ted under the law to hold real estate on their own accounts as capital assets and for investment purposes.

In addition to the cases immediately cited we refer the Court to the cases cited under paragraph Numbered 2. of the *SUMMARY OF ARGUMENT.*

III.

Where property is acquired by taxpayer and sales made with little or no activity on his part, the profits realized therefrom are entitled to capital gain treatment.

We have cited a long list of cases on this point under SUMMARY OF ARGUMENT paragraph numbered 3, and refer the court thereto.

We particularly call attention to the fact that the evidence shows that neither appellants nor Evans had given any thought or consideration whatsoever to selling this particular parcel of ground. The sale was in no way sought or solicited by them. On the other hand the purchasers came to them after they had looked the ground over and decided that it was suitable for their purposes as a chemical plant. The owners had no fixed price. The first approach made to the owners was in November 1947. The sale was not consummated until May 1948. It was wanted for a special purpose. Had it been offered for sale in the ordinary course of business as a real estate dealer it would have had to have been offered as farm land. Had it been condemned it would have had to take a value as grazing land, according to the rules of evidence

in determining market value for that was the use to which it was being put.

IV.

Where lawyer taxpayer acquired property and made sales which were unsolicited on his part, the profit made from such sales was income from the sale of a capital asset and entitled to capital gain treatment.

We refer to the cases cited under SUMMARY OF ARGUMENT paragraph numbered 4 on this point. They are largely cumulative of the authority set forth under point 3 above, but we feel that a reading of these cases will add light to the consideration of this case.

Before concluding our argument we desire to submit to the court additional authority in support of our position by way of informing the court as to the position recently taken by the Bureau of Internal Revenue with regard to the 80 acres sold by appellants and Evans to Roy Lindley, testimony concerning same appearing in the transcript at page 34 as follows: (F. M. Bistline testifying).

> "Since the sale of this piece of property to Westvaco, which was in the public interest, we have made one sale of a parcel of this land. This one sale was made in 1953. In 1953 Mr. Evans and I had been contemplating bringing another 80 acres under cultivation which cornered on the 200 we had in cultiva-

tion. However, Mr. Lindley had just put in a pressure system on the land which was immediately west of it, and put in a main line of his pressure system right over to the edge of it. He came to us and talked us out of going ahead with it. He said he would like to buy it, and finally got the price where we figured it was better to sell to him than for us to go and develop the land and we sold it to him."

We quote from the report received from the Assistant Regional Commissioner, Appellate, San Francisco Region, 504 Dooly Building, Salt Lake City, Utah, under date of May 6, 1957 as follows:

"ADJUSTMENTS TO NET INCOME—Taxable year 1953.

"EXPLANATION OF ADJUSTMENTS (a) and (b). The adjustments made in the Revenue Agent's report, taxing the gain from the sale of a one-half interest in 80 acres of property as ordinary income from business instead of as a long-term capital gain as reported on the return, is reversed."

This land was acquired at the same time, was used for the same purposes as the 210 acres sold to Westvaco. The Internal Revenue Service has recognized the error of its ways. The laws had not been changed regarding such sales between 1948 and 1953.

CONCLUSION

In conclusion we submit that under the law and the evidence of this case that appellants are entitled to a reversal of the judgment with instruction to the court below to enter judgment in favor of the appellants for the recovery of the taxes paid on ordinary gain on the sales of the 210 acre tract of land sold to the Westvaco Chemical Company for a factory site.

Respectfully submitted,

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